THE TAXATION OF CORPORATIONS. III.

THE discussion of corporation taxation would be incomplete without an examination of the various phases of duplicate taxation. This is all the more necessary for the reason that no attempt at a thorough analysis has ever yet been made. And yet the problems that hinge about this particular subject are so especially important in the United States as to demand the most serious attention.

What is meant by double taxation? Double taxation in the wider sense exists when the same or different persons are taxed twice upon the same source, whether this be property, income or any other element. Thus if two different persons like mortgagor and mortgagee are assessed on the same piece of land, it is double taxation. Or if the same person is taxed by two different states or localities on his income and on the property from which the income is derived, this again is double taxation. It is a mistake, however, to think that all duplicate taxation is necessarily unjust. Much confusion has arisen on precisely this point. Double taxation is unjust only when the principle of equality is violated. This is usually, but not necessarily the case. We can ascertain the limits of the principle only by analyzing separately each of the various kinds of duplicate taxation.

There are in reality no less than five different forms of double taxation in the case of corporations. These are:

1. Double taxation of property and debts or of income and interest on debts.
2. Double taxation of property and income.
3. Double taxation of property and stock.
4. Double taxation arising from interstate, intermunicipal or foreign complications.
5. Double taxation of the corporation and the holders of stock or bonds.

Three of these forms, it will be perceived, are applicable also to individuals, as well as to corporations. Let us discuss them in order.

VII. *Double Taxation of Property and Debts.*

This first point need not detain us long. It applies in this country only to the general property tax, which we have discarded as the basis of corporation taxation. Moreover, in the case of individuals this means practically the question of taxation of mortgages and book debts, which has been discussed in a previous article.[1] Finally, in so far as corporations are concerned it has been pointed out [2] that there is really no injustice at all in not exempting corporate indebtedness. The issue of mortgage bonds by a corporation is simply another mode of increasing the working capital. Correct policy demands the taxation of corporate bonds as well as of stock, of loans as well as of share-capital. To tax corporate debts may indeed be called double taxation in so far as the tax on both property and debt is paid out of the same income; but if so, it is double taxation of a perfectly legitimate kind. It is here that the principles of individual and corporation taxation diverge.

Some of the Swiss cantons, like many of the American commonwealths, recognize this distinction between the taxation of individuals and that of corporations, by permitting the deduction of indebtedness from the property of individuals but refusing a like deduction in the case of corporate property. Such *e.g.* is the system in St. Gallen, Zürich, Ticino, *etc.*[3]

Perhaps more interesting and probably of greater future importance in the United States is the other phase of this question of the taxation of indebtedness — double taxation of income and interest on debt. While the true theory of income taxation in the case of individuals necessarily demands the deduction of interest on debts, it has already been shown that in the case of corporations the interest paid on mortgage bonds

[1] The General Property Tax, POLITICAL SCIENCE QUARTERLY, V, 1 (March, 1890), p. 32.

[2] *Ibid.* V, 3 (Sept., 1890), p. 452.

[3] Schanz, Die Steuern der Schweiz, II, 338; II, 435; IV, 281.

must be included in the taxable income.[1] Taxation of interest on corporate debt is not double taxation, because the coupons, like the dividends, are integral parts of the income; because both bonds and stock together form what is really the working capital from which the income is derived. This whole question, however, has already been discussed. The radical difference in economic significance between a corporate bond and an individual debt must be continually borne in mind.

VIII. *Double Taxation of Income and Property.*

This second form of double taxation, like the first, involves no very complicated question; nor does the solution present any difficulties. Is it permissible to tax a corporation both on its property and on its net receipts or income? If corporations are put upon the same plane as individuals, then the simultaneous taxation of the property and of the income from the property works no injustice. If all are treated alike, it makes no difference in this respect whether there is one single high tax on property, or a low tax on property and another low tax on the profits of the property. In fact, the government would be perfectly justified in taxing the property and the income of the property and the expenses of the property and any other attribute of the property. And all these duplicate or triplicate taxes are perfectly reasonable as long as they fall equally on all. Taken together, they simply amount to a high rate for a single tax on the property. As was intimated above, double taxation is not always wrong. It is unjust only when one taxpayer is assessed twice while another in substantially the same class is assessed only once. It is the inequality of taxation that instinctively shocks us. If the tax is uniform, if all persons within the class are equally subjected to the burden, no

[1] The great defect of the otherwise admirable study of Heckel, Die Einkommensteuer und die Schuldzinsen (1890), is the failure to distinguish between corporations and natural persons. He indeed is forced to the practical conclusion that corporations must be liable for the tax on mortgage debts, but his arguments are weak and inconclusive; *cf.* p. 182. The only sound argument is the one used in the text, — the fundamental distinction between corporate bonds and individual debts.

complaint can be lodged with justice against this sort of double taxation.

As this particular problem is not peculiar to corporations, its more extended consideration may be deferred to another place. So far as corporations are concerned, it is not a matter of practical importance. The only case in which this special question has arisen in the United States was under the laws of Alabama, now repealed, which provided for the taxation of corporate property and also of the corporate income during the preceding year.[1] Such taxation was upheld on the ground that it was only apparently double taxation.[2] What the court meant was, of course, not that it was not double taxation, but that it was not invalid or economically unsound taxation. And in this the court was perfectly correct. For the law applied equally to all individuals and corporations.

At present in the United States no attempt is made to tax simultaneously both corporate property and corporate income.[3] The nearest approach to the practice is the Pennsylvania and New York system of taxing the capital stock and also the gross receipts of certain corporations. No objection has ever been raised to these taxes on the score of double taxation; nor is it likely that such an objection ever will be raised. One might as well object to a combination of direct and indirect taxes as to duplicate taxation, on the ground that all taxes are in the last resort paid (or presumed to be paid) out of annual income. But this objection would be manifestly absurd. This second form of double taxation is thus entirely proper.

The classic home of double taxation of this sort is Switzerland. As has been shown repeatedly in the preceding essays, Switzerland has become so conscious of the manifold defects of the general property tax as to have added to it with increasing rapidity in the various cantons a tax on incomes. In this

[1] Ala. laws of Feb. 22, 1866; Feb. 19, 1867; Dec. 31, 1868; March 19, 1875; March 6, 1876.

[2] Board of Review *vs.* Montgomery Gas Light Company, 64 Ala. 276. *Cf.* Lott *vs.* Hubbard, 44 Ala. 593.

[3] The question as applied to individuals, as *e.g.* in the Massachusetts income tax, will be discussed elsewhere.

respect corporations are in most cases treated like individuals. Baselstadt, *e.g.*, taxes corporations one per mill on the paid up capital, a quarter of one per mill on the capital not yet paid up, and one per cent on the total net income from all sources.[1] In Baselland corporations are taxed on their general property and again on their total profits, with the sole exception that when any of the profits consist of interest on capital the profits are not taxed if the capital has already been assessed.[2] Many of the cantons, however, seek to avoid the simultaneous taxation of property and income by a curious arrangement of the following sort. While the law provides for the assessment of both property and income, a deduction is made in the case of the income tax for so much of the income as is supposed to represent the actual profits of the capital already taxed. The proportion thus deducted is fixed in accordance with the estimated current business interest, ranging from four per cent in Thurgau and Grisons to five per cent in Zug, Schaffhausen, Ticino, Vaud and Zürich. The federal government deducts five per cent.[3] Bern and St. Gallen are the only cantons which attempt to draw a sharper line by levying the property tax only on the corporate real estate, but subjecting all the other property to an income tax.[4] In St. Gallen the real-estate tax is for local purposes, the income tax for cantonal purposes.

The solution of the supposed difficulty attempted by the majority of the Swiss commonwealths is, however, not a happy one. The deduction from income of the four or five per cent, presumed to represent the earnings of property, involves a misconception. It is impossible to say how much of the income represents earnings of capital and how much represents the other ingredients of profit. We are brought face to face with complicated questions of economic theory — with the distinction between interest and profits, and the separate distinct ingredients of profits. A discussion of these knotty questions lies, of course, beyond the province of this essay. But it may be confidently

[1] Law of 1889, §§ 2, 3. Schanz, Die Steuern der Schweiz, II, 84; V, 50.

[2] Schanz, *op. cit.* I, 55; V, 35.

[3] *Ibid.* I, 56.

[4] *Ibid.* II, 318, 368; III, 292.

asserted that if a railway corporation with no bonded indebtedness and a capital of one million dollars earns seventy-five thousand dollars, it is absolutely impossible to maintain that fifty thousand dollars represents the earnings of the property and the remainder represents the earnings of the management. From one point of view all profits are profits on capital or property. An individual indeed can obtain a professional income without any capital. But in the case of a business with capital invested, it is impossible to say how much of the profits are due to the capital, how much to the personal management. Without the capital there would be no profits at all, because there would be no business. Therefore, in taxing profits we are really taxing property, or rather the proceeds of property. To segregate a part of these proceeds, and to say as do the Swiss cantons that only this particular part represents the income from the property, is an entirely arbitrary proceeding.

Again, it cannot be contended that this four or five per cent of income exempted by the Swiss laws represents only the interest on the capital, and that the remainder of the income represents only the earnings of management. For under no theory of economic profits can the surplus above current interest be entirely dissociated from capital. Even granting that a sharp line can be drawn between interest, earnings of management and profits, it still remains incorrect to confine the proceeds of capital to interest alone. It is thus inadmissible to say that in taxing income only on the surplus above four or five per cent of the taxable capital we are not taxing both property and income.

The Swiss system indeed has a very decided significance in connection with an entirely different matter, *viz.*, the question of funded or unfunded income. But as regards the point now under discussion it is evident that the Swiss cantons do not really succeed in avoiding double taxation. As we have seen, however, it is a form of double taxation which is perfectly legitimate.

IX. *Double Taxation of Property and Stock.*

This third form of duplicate taxation must not be misunderstood. It does not refer to the taxation of shares of stock in the hands of individuals. That is a far more intricate problem, and falls under the fifth heading, to be discussed below. The point here is this: Is it permissible to tax the corporation on its property and again on its capital stock?

The answer is plain. Manifestly not, if the corporate stock can be regarded as representing actual property. We have, indeed, seen that it is a mistake economically to say, as do some of our courts, that the entire property of a corporation is identical with its capital stock. This point has been brought out so well in a Massachusetts case, and is so generally misunderstood, that it may be wise to make a more extended quotation from the decision:

> The market value of the shares of a corporation . . . does not necessarily indicate the actual value or amount of property which a corporation may own. The price for which all the shares would sell may greatly exceed the aggregate of the corporate property, or it may fall very far short of it. Undoubtedly the amount of property belonging to a corporation is one of the considerations which enter into the market value of its shares; but such market value also embraces other essential elements. It is not made up solely by the valuation or estimate which may be put on the corporate property, but it also includes the profits and gains which have attended its operations, the prospect of its future success, the nature and extent of its corporate rights and privileges, and the skill and ability with which its business is managed. In other words, it is the estimate put on the potentiality of a corporation, on its capacity to avail itself profitably of the franchise, and on the mode in which it uses its privileges as a corporate body, which materially influences and often controls its market value.[1]

But while it is perfectly true that capital stock and total property are not interchangeable terms, it cannot be denied that the capital stock of a corporation represents at all events a

[1] Commonwealth *vs.* Hamilton Manufacturing Company, 12 Allen, 303. *Cf.* my preceding article, POLITICAL SCIENCE QUARTERLY, V, 3 (Sept. 1890), p. 447.

part of its property, or rather that the corporate property is one of the elements that contribute to the value of the capital stock. If this be true, then an increased tax on the corporation on account of its stock is *pro tanto* duplicate taxation of an unjust character. If other persons are taxed only once on their property, corporations should not be taxed again on what is at all events a part of their property.

Unfortunately there is no absolute uniformity in our legal decisions on this point. While the majority of the commonwealths hold taxation of this kind to be unjust duplicate taxation, Pennsylvania has pronounced it perfectly valid. In a celebrated case the court used this language:

> Double taxation has never been considered unlawful in this state. The real and personal property of a corporation may be taxed, although it pays a tax on the stock which purchased it. The power of the legislature is as ample to tax twice as to tax once, and it is done daily as all experience shows. Equality of taxation is not required by the constitution.[1]

Such a decision may be correct legally, but beyond all doubt it is unsound economically. Equality of taxation may not be required by the constitution of Pennsylvania, but it is one of the first and most cardinal laws in the whole science of finance. Abandon equality, and you throw the door wide open to all kinds of glaring abuses. The Pennsylvania view cannot possibly be upheld from the scientific standpoint.

Far wiser are the Maryland courts, which hold that all laws must be so construed as to avoid double taxation of this kind; and that, since in their opinion the capital stock of a corporation represents the corporate property, the payment by the corporation of a tax on capital stock necessarily exempts all the corporate property.[2] In this broad form the decision is perhaps open to criticism because of the complete identification of capital stock with corporate property. But as regards the point at

[1] Pittsburgh *etc.* R.R. Co. *vs.* Pennsylvania, 66 Pa. State, 77. *Cf.* Lackawanna Iron Co. *vs.* Luzerne County, 42 Pa. State, 424.

[2] County Commissioners *vs.* National Bank, 48 Md. 117. *Cf.* State *vs.* Stirling, 20 Md. 520; State *vs.* R.R. Co., 40 Md. 22.

issue here, it is perfectly correct. To tax corporations simultaneously on their stock and on their property is wholly indefensible. And a few commonwealths, like Maryland, Illinois, Alabama and (for local purposes) New York, have now recognized this principle in their statutes, deducting from the value of the capital stock the value of the realty or of both the real and personal property taxed.[1]

On the other hand, the apparently similar statute of Massachusetts, which taxes corporations on their capital stock less the value of the real estate and machinery,[2] is indefensible for quite another reason. According to the Massachusetts law, corporations are taxable locally only on their real estate and machinery, while they are taxable for commonwealth purposes only on the value of the capital stock deducting the value of the real estate and machinery. Corporations are therefore taxed only once on their total property. Individuals on the other hand pay not only a tax on general property for state purposes, but another general property tax for local purposes,— not to speak of the income tax. Corporations thus are treated more leniently than individuals. According to the theory developed in the preceding essays corporations should always be locally taxable on their realty. But the commonwealth tax should be levied on the total income or, if the states will still persist in the property tax, on the total property without any deductions (except those arising from considerations of interstate comity and equity, to be discussed below). My whole treatment of double taxation is based on the assumption that the double tax is levied by administrative units of the same grade, whether states or local divisions. It manifestly does not apply to cases where one tax is levied by the commonwealth, and another similar or different tax is levied by the county or city, as in Massachusetts. Otherwise we should be forced to the conclusion that our property tax always involves a duplicate,

[1] Md. law of 1878, in Pub. Gen. Laws, art. 81, §§ 84, 85, 141–144; Ill. Rev. Stat. chap. 120, § 3, sec. 4; Ala. Code, § 453, sec. 8; New York, Laws of 1857, chap. 456, § 3, vol. 2, p. 1. In New York, as we know, corporations are locally taxable on their realty, and also on their capital stock, deducting the amount invested in real estate.

[2] Mass. Pub. Stat. chap 13, § 40.

triplicate or quadruplicate taxation in so far as state, county, town and village levy different rates on the same property. But this is only a juggle with words. Such taxation is not in the scientific sense double taxation. Strictly speaking, therefore, the Massachusetts principle while ostensibly sound is really incorrect.

In Switzerland, the only other country in which the property tax exists, we find, in the few cases where both tangible property and capital are assessed, that the value of the taxable property is deducted from the corporate capital. Thus the new constitution of 1885 in Aargau provides for the taxation of the corporate real estate for both commonwealth and local purposes. The value of the realty is then deducted from the capital stock.[1] So also in Schaffhausen.[2] The Swiss tendency, like the American, is gradually coming to be in accord with the sounder principles.

We come now to the most important aspects of double taxation — the fourth and fifth forms. Here we have the benefit of a wide European experience. In the phases of duplicate taxation hitherto treated we can learn very little from Europe, because in no European state except Switzerland are the corporations taxed on their property as a whole; and in Switzerland the whole question of corporation law is in a far more inchoate condition than in the more developed industrial states. But the problems that we take up now present themselves in Europe as well as in this country, and have there received in some points an extended consideration, although not a completely successful solution.

X. *Double Taxation arising from Interstate, Intermunicipal or Foreign Complications.*

This fourth form of duplicate taxation appears in connection with almost every method of corporate taxation. It is so comprehensive that it will be advisable to discuss the subject under four chief headings:

[1] Schanz, Die Steuern der Schweiz, II, 239. [2] *Ibid.* II, 170 (note 1).

A. Double taxation of corporate property.

B. Double taxation of stock and bonds or of dividends and interest.

C. Double taxation of non-resident stockholders or bondholders.

D. Double taxation of corporate receipts or income.

A. *Interstate double taxation of corporate property.* The difficulty here arises in connection with the taxation of personal property. In the case of real estate the rule universally adopted in the United States is that the property should be taxed where it is situated. There is accordingly no chance for interstate complications. But in the case of personalty the great problem is that of *situs*. Should the personalty be taxed where it is situated or should it follow the domicile of the owner? The legal conditions in the United States are chaotic.

As a general rule the personalty of individuals, if actually located in a state, is taxable there.[1] Yet in most commonwealths the legal fiction prevails that personalty follows the owner — *mobilia personam sequuntur.* This rule is certainly applicable to choses in action and all other intangible personalty. Accordingly, if the owner is a non-resident, the result will be a double taxation of his personal property, once by the state where it is located and again by the state of his residence. A few commonwealths indeed have provided by statute for the exemption of a resident's personalty if permanently located and taxed in another state. Such is now the law in Connecticut, Indiana, Maine, New Jersey, Rhode Island, South Carolina, Vermont and West Virginia.[2] The same rule has been extended by judicial interpretation to Illinois, Kansas,

[1] Cooley on Taxation, 2d ed. (1886), 373, 374. See especially Coe *vs.* Errol, 116 U. S. 517, where the court terms this an "elementary point."

[2] Conn. Gen. Stat., secs. 3828–3830 (applies only to property actually invested in merchandising or manufacturing); Ind. Rev. Stat., sec. 6287; Me. Rev. Stat., tit. i, sec. 14, § 10; N.J. Rev. Stat. [1877], p. 1151; R.I. Pub. Stat., chap. 42, sec. 9 (applies only to machinery, machine tools, stock in trade, merchandise, lumber, coal and stock in livery stables); S. C. Rev. Stat., chap. 12, sec. 1; Vt. Rev. Laws, sec. 270; W. Va. Code, chap. 29, sec. 48. *Cf.* on this point Moore, Corporate Taxation, in *American Law Review*, 1884, p. 766.

Missouri, New York and Ohio.[1] In other commonwealths the rule is applied only in part. Thus in Arkansas, South Carolina and Virginia a similar exemption is made for all personalty except in so far as money, credits or investments in business are concerned.[2] Again in Delaware only so much of the personalty is exempt as consists of non-productive securities of other commonwealths.[3] Finally in Michigan all the personalty of a resident is taxable except that which is invested in another commonwealth.[4] But in most of the commonwealths the legal fiction still prevails, and the individual is taxed on all his personalty irrespective of its location. The obvious result, of course, is double taxation of a nature which cannot possibly be justified.

In the case of corporations, we are confronted by precisely the same difficulties. For corporate property is treated in the main like that of individuals. It is entitled to the same exemp tions and subject to the same conditions. It will be readily perceived, however, with what difficulties the problem is beset when, as is usually the case, the personalty of a corporation is assessed at its place of business as the legal *situs*. In Michigan, indeed, it has been held not permissible to tax corporations for property outside the state.[5] And in South Carolina the tax is specifically limited to corporate property within the state.[6] But in general the rule is the same as in the case of the property of individuals — a rule leading to double taxation with all its attendant injustice.

Manifestly, if the commonwealths will still cling to the policy of taxing the actual corporate property, the only logical and

[1] Mills *vs.* Thornton, 26 Ill. 300; Fisher *vs.* Commissioners of Rush County, 19 Kan. 414; State *vs.* St. Louis County, 47 Mo. 594; People *ex rel.* Hoyt *vs.* Commissioners, 23 N.Y. 224; Carrier *vs.* Gordon, 21 Ohio, 605. *Cf.* for the practice and cases up to 1871, (First) Report of the (New York) commissioners to revise the laws for the assessment and collection of taxes (1871), pp. 130–147.

[2] Ark., Mansfield's Digest, sec. 5048; S. C. Gen. Stat., chap. 11, sec. 149; Va. Code, sec. 492.

[3] Del. Laws 1879, chap. 2.

[4] Mich. Laws 1885, no. 153, sec. 2.

[5] State Treasurer *rel.* *vs.* Auditor General, 46 Mich. 224.

[6] S. C. Rev. Stat., chap. 12, sec. 28.

just method is for each state to exempt so much of the corporate property as is already taxable in another state. The proposition is too obvious to require any proof. The federal government has unfortunately not exercised its right to compel such uniformity, if indeed it possesses any such right — a question of grave doubt. Our only hope, therefore, lies in the progress of the commonwealth conscience. Until then we shall still be confronted by the present chaos.

B. *Interstate double taxation of stock and bonds or of dividends and interest.* The evils arising from the simultaneous taxation by different states of the same corporate stock or bonds have been so patent as to lead to statutory changes and judicial interpretations of considerable importance. In Pennsylvania, after being long the custom, it has now been judicially decided to be the law that the tax on capital stock applies not to the whole capital but only to such a proportion of the capital stock as is employed, either actually or constructively, within the state.[1] In New York, the original statute attempted to follow the old rule. But the law has now been so amended as to provide expressly for the taxation of only so much of the capital stock as is employed within the state.[2] In a case which arose under the old statute, although decided after the passage of the amendment, the Court of Appeals declared itself forced to adhere to the old rule.

> It is extremely hard and unjust, . . . but we are unable so to construe the statute as to relieve it [the corporation] therefrom. . . . The injustice of such a basis of taxation has finally been recognized by the legislature.[3]

The principle in both these commonwealths now applies equally to domestic and to foreign corporations. In Massachusetts, where the tax is applicable only to domestic corporations, no such distinction is drawn. The general corporation tax is levied there on the total capital stock irrespective of its employment.

[1] Commonwealth *vs.* Standard Oil Company, 101 Pa. State, 119. As to the previous custom, *etc.*, see Decisions of the Auditor-General for 1878–80, p. 296.

[2] New York Laws of 1885, chap. 501, p. 858.

[3] People *vs.* Horn Silver Mining Co., 105 N. Y. 76, esp. 88. Decided in 1887.

So far as railroads are concerned, it has become the common practice in this country to assess only so much of the capital stock as is represented by the proportion of the mileage in the state to the total mileage. The same rule is observed in those cases when both stock and bonds are taxable, as in Connecticut. Such a standard, while not perfectly exact, is perhaps as nearly accurate as can be attained. And it has been upheld as an entirely constitutional method.[1] This principle of mileage is applicable equally to telegraph companies and to other transportation companies. And in such cases it is gradually being introduced, although not quite so commonly as in the case of railroads, in all those states which tax capital stock directly. The principle is a sound one.

For other corporations, however, it will readily be seen how vague is the New York and Pennsylvania doctrine of "capital employed within the state." What business firm or corporation with ramifications all over the country can tell exactly or even approximately how much of its capital is "employed" within any one state? And even could they tell, how many of them will tell, if concealment will enable them to evade the tax? In some of our commonwealths the state officers have the right to inspect the books of the corporation and to change the assessment if they deem it too low. But even then, what guarantee is there that they will discover the real proportion? The taxation of so much of the capital as is employed within the state is a difficult problem to solve.

It is interesting to notice a recent New York decision on this point. A Massachusetts corporation — a telephone company — was taxed in New York by apportioning the whole capital according to the proportionate number of telephones used in the state. Although the whole tax was declared invalid for another reason, *viz.* that the corporation was not technically doing "business" in the state, the court entered into a discussion, *obiter* indeed, of the question with which we are dealing here. Chief Justice Ruger used the following language:

[1] Delaware Railroad Tax Case, 18 Wall. 208; Erie Railroad *vs.* Pennsylvania, 21 Wall. 492.

> It is by no means clear that the mode adopted . . . produces a correct result. . . . We are quite unable to sanction a principle which would subject it [the corporation] to the liability of being taxed, not only in [the state] where it is located, as it undoubtedly would be under the law as laid down by us [in the Horn Silver Mining Company case], on its entire capital stock and gross earnings; but also in each state of the Union in which it should own telephones on such proportion of its capital stock and gross earnings as the law-makers of such state saw fit to impose.[1]

It is difficult to see the justice of this conclusion. It happens to be true that Massachusetts still follows the incorrect and inequitable plan of taxing the whole capital. But that is no excuse for the New York court to interpret the old statute in the same way, or to assume that other states will also follow the precedent which the court itself pronounces "extremely hard and unjust." Two wrongs do not make a right. In the absence of any federal law regulating the subject, the only upright course for each commonwealth to pursue is to follow the dictates of interstate comity and the sound principles of the science of finance by taxing only so much of the corporate capacity as is economically speaking within its jurisdiction. As we have repeatedly said, the taxation of corporate stock is by no means the ideal method. But if the New York principle of taxing capital stock and gross earnings be nevertheless followed, it is difficult to discover any more practicable or more defensible method of ascertaining the due proportion of capital stock employed or gross profits earned within the state than by considering the number of, or royalties from, the telephones used. It is analogous to the Connecticut system of proportional mileage as applied to railroad companies. And in the case of telephone companies, the number of instruments used is a better test than the mileage of the telephone wires; for the capital as well as the expenses are in far more direct proportion to the number of telephones in use than to the amount of the wire employed.

C. *Interstate double taxation of non-resident bondholders or stockholders.* The subject of taxation of corporate stock or

[1] People *vs.* American Bell Telephone Co., 117 N.Y. 242, especially 256.

bonds is complicated in another way by the question of extra-territoriality. The problem is simply this: Can a corporation, even though its capital be wholly employed within the state, be taxed on its capital or bonded debt if these are owned in part by residents of another state?

The federal Supreme Court has arrived at some very remarkable conclusions. In so far as bonds are concerned, the above practice has been pronounced unconstitutional. In one case it has been held that a state tax on bonds issued by a railroad company and secured by a mortgage on a line lying partly in another state was void, because the state was taxing to that extent "property and interests beyond her jurisdiction."[1] A later case went further and decided in general terms that a tax on corporate bonds is invalid as to non-resident owners because the debts are not the property of the debtor, *i.e.* the corporation, but of the creditors, *i.e.* the bondholders. They are the obligations, not the property of the debtors. But the creditors cannot be taxed on their property because they are not within the jurisdiction of the state.[2] The particular statute in this case was the Pennsylvania law of 1868. The state courts which had hitherto entertained a different opinion were compelled to acquiesce. And in a later case, decided in the same commonwealth, the state tax on corporate loans, *i.e.* on bonded indebtedness, was upheld only in so far as it applied to the bonds owned by residents.[3] This, therefore, is the accepted law of the land.

On the other hand, shares of stock are treated quite differently. It has indeed been decided that a state tax on dividends is unconstitutional as to non-residents if the corporation be required to withhold the tax from the dividends.[4] But a state tax on capital stock, even though the stock be held partly by non-residents, is pronounced legitimate on the ground that the tax is a tax on the corporation as a whole, and not on the indi-

[1] Railroad Company *vs.* Jackson, 7 Wall. 262.

[2] State Tax on Foreign-held Bonds, 15 Wall. 300.

[3] Commonwealth *vs.* Delaware Division Canal Co., 123 Pa. 594.

[4] Oliver *vs.* Washington Mills, 11 Allen, 268.

vidual shareholder.[1] A recent case has even decided that a state tax on the shares of stockholders which the company is required to pay irrespective of dividends, is not a tax on the shareholders but on the corporation.[2] This is true notwithstanding the fact that in another case a tax on dividends or interest paid by the corporation was held to be a tax on the income of the stockholder or the creditor and not on the income of the corporation.[3]

The present state of the law therefore is that the entire capital stock of a corporation may be taxed by any commonwealth, but that only so much of the bonds are taxable to the corporation as are owned by residents of the state. The mere statement of this proposition makes it evident how impracticable and unserviceable would be the otherwise defensible taxation of corporate property represented by its stock and bonds. The Connecticut system, which at first blush seemed to be an admirable solution of the problem in so far as transportation companies are concerned,[4] would thus appear to be shorn of its chief merits, if the present law of the land is sound law. The great majority of states, whose corporation bonds are owned mainly outside of the state in large financial centres like New York or Boston, would find such a tax sadly inadequate. And even in the state of New York, where the comptroller is now clamoring for a tax on corporate indebtedness, the proceeds would fall far below the actual capacity of the corporation. The decisions of the Supreme Court prevent, it is true, double taxation, but they prevent it so effectually as also to prevent just taxation.

From the economic point of view, these decisions are indefensible. If the tax on capital stock is a tax on the corporation, then the tax on mortgage bonds is equally a tax on the corporation. It is stock and bonds together that represent the corporate property. For the value of the stock is diminished by the existence of the bonds. The bondholders, viewed from

[1] Delaware Railroad Tax Case, 18 Wall. 208.
[2] New Orleans *vs.* Houston, 119 U. S. 265.
[3] United States *vs.* Railroad Co., 17 Wall. 332.
[4] POLITICAL SCIENCE QUARTERLY, V, 3 (Sept., 1890), p. 464.

the economic standpoint, are no more creditors of the corporation than are the stockholders. Both together are coproprietors, just as mortgagor and mortgagee are in economic fact co-owners of the land. It is impossible to see any economic justification for taxing non-resident stockholders while exempting non-resident bondholders. The same rule should be applied to both classes, for their interests in the corporation's prosperity are in this respect precisely the same. The original Pennsylvania decision which was reversed by the federal Supreme Court rested on an earlier case involving much the same question, known as Maltby's Case. And with all due deference to our Supreme Court it must be stoutly maintained that to the student of political economy the original Pennsylvania decision is far sounder than that rendered by the federal tribunal. In Maltby's Case the court uses the following language:

> What would the plaintiff's [a non-resident] loan be worth if it were not for the franchises conferred upon the corporation by the commonwealth [of Pennsylvania], franchises which are maintained and protected by the civil and military power of the commonwealth. . . . It is on this ground that the legislature discriminates between corporation loans and private debts as objects of taxation. . . . *The loans and stocks of a railroad company resemble each other in many respects.* Both are subscribed under the authority of a special law, and *both are so far capital* that they are employed for the same general purposes. . . . Although loans and stock are distinguishable for many purposes, yet the legislature committed no very great solecism in treating loans as taxable property within our jurisdiction. . . . Corporation loans, though in one sense mere debts, are like moneys at interest, taxable as property.[1]

This is perfectly sound political economy, although it is not now the law of this country. The supposed difficulties which might arise from the application of the principle, in so far as the taxation of the bondholder by the state of his residence also are concerned, will be seen to vanish when we discuss further below the question of incidence. For if, as I hope to show, it is not double taxation for the same state to tax the corporation on its loans and the bondholder on his bonds, it can certainly

[1] Maltby *vs.* Reading and Columbus Railroad Company, 52 Pa. State, 140.

not be double taxation for one state to tax the corporation and the other state the bondholder.

It is remarkable that, in several cases decided since the leading case of the state tax on foreign-held bonds, the Supreme Court has applied to the relations between the federal government and foreign states a principle entirely different from that which it invoked in the case of the commonwealths. It has been held that the national tax imposed during the civil war on the dividends, coupons and profits of transportation companies is an excise tax on the business, and that it is perfectly valid even though the dividends or interest are withheld from a foreign stockholder or bondholder.[1] Justice Field in a dissenting opinion showed the incongruity between these decisions and the earlier ones as applied to commonwealth laws. He said:

> If the United States can do this, why may not the states do the same thing with reference to the bonds issued by corporations created under their laws? What is sound law for one sovereignty ought to be sound law for another.[2]

But this protest was in vain. The legal status of the problem is therefore an anomalous one. The federal government can impose a tax on the total stock and bonds, or total dividends and interest of corporations, irrespective of the question of foreign-held securities. But the separate commonwealths, which are treated like foreign countries in the case of corporate stock or dividends, can impose a tax on only so much of the bonds or interest as is owned by or due to residents. This is of course an absolutely illogical situation.

A peculiarly interesting complication arises in those commonwealths where the law of mortgage has been changed for tax purposes. One of the chief grounds of the decision in the Foreign-held Bond Case was that since the railroad lands on which the bonds and mortgages were issued lay in Pennsylvania, the non-resident bondholder had no property therein. Said Justice Field:

[1] Railroad Company *vs.* Collector, 100 U. S. 595, decided in 1879. United States *vs.* Erie Railroad Company, 106 U. S. 327, decided in 1882.

[2] 106 U. S. 335.

The property in no sense belonged to the non-resident bondholder or to the mortgagee of the company. The mortgage transferred no title; it created only a lien upon the property. Though in form a conveyance, it was both in law and equity a mere security for the debt. The mortgagee has no estate in the land.

It would be interesting, if this were the proper place, to trace the law of mortgage through both the Roman and the English law, and to show that in both systems the mortgagee had originally both possession and property, that in a later stage he had no property in the land but retained the possession, until finally he had neither property nor possession, but simply a lien.[1] Be that as it may, it is true that Justice Field correctly represented the American law on the subject. That the mortgagee has no estate in the land is the Pennsylvania law.[2] And precisely similar cases have been decided in the same way in other commonwealths. Thus, in an Iowa case, a corporation mortgage held by a non-resident was declared non-taxable in Iowa because "the mortgagee has only a chattel interest. . . . The mortgage is personal property . . . and attaches to the person of the owner."[3] So also under the old constitution of California, a case of intermunicipal taxation was decided in the same way. A judgment of record in one county upon the foreclosure of a mortgage situated in that county, the owner of the judgment being the resident of another county, was held not taxable in the first county because "the thing secured by the mortgage is intangible and has no *situs* distinct and apart from the residence of the holder. It pertains to and follows the person."[4]

It will be seen that all these cases turn upon the point that the mortgage is personal property. But in California, Oregon and Massachusetts, as we know,[5] it has been expressly provided

[1] For the Roman law of *fiducia*, *pignus* and *hypotheca*, see Hunter, Roman Law, pp. 262–276. For the development of the English law, see Digby, An Introduction to the History of the Law of Real Property, chap. v, § 5 (2).

[2] Rickert *vs.* Madeira, 45 Pa. State, 463.

[3] Davenport *vs.* The Mississippi and Missouri Railroad Co., 12 Iowa, 539.

[4] People *vs.* Eastman, 25 Cal. 603. See also State of Nevada *vs.* Earl, 1 Nevada State, 397; State *vs.* Ross, 3 Zabriskie, 517.

[5] The General Property Tax, POLITICAL SCIENCE QUARTERLY, V, 1 (March, 1890), p. 35.

that the interest of the mortgagee should be considered, for purposes of taxation only, as realty, not as personalty. This completely changes the whole situation and entirely undermines the foundation of the decision in the Foreign-held Bond Case. If the interest of the non-resident bondholder, *i.e.* the mortgagee, is no longer personalty but real estate, it does not follow the person of the bondholder but may be taxed by the commonwealth in which the corporation is situated. The taxation of non-resident bondholders must thus be assimilated in these states to that of non-resident stockholders. The federal decision will therefore be applicable to one part, but inapplicable to another part of the United States. It may even happen that the corporate property covered by the mortgage is situated in several different states, so that part of the bonds may be subject to one law, part to another. The ensuing complications may be easily imagined. It would be far better for the Supreme Court to abandon the whole contention and to reverse its decision on purely economic grounds. In assessing a tax on capital stock or bonded debt it should be entirely immaterial whether or not some of the stockholders or bondholders lived without the state. The residence of the security holder should have nothing to do with the taxation of the corporation.

D. *Interstate double taxation of receipts or income.* This phase of interstate double taxation presents far less difficulties. In regard to gross receipts the test is a very simple one, *viz.* the gross receipts from business done within the state. In the case of insurance companies this is fast becoming the general rule in this country. It is applicable, as we have seen, to all corporations except transportation companies. The reason for the exception is that a tax on business transacted wholly within the state would result in a practical exemption of the larger part of railway earnings — that derived from or in any way connected with interstate transportation. As to other corporations, however, the gross-earnings tax can be easily arranged so as to obviate double taxation.

But if the gross-earnings tax be discarded, as we have sug-

gested, and if a tax on net receipts or income be imposed, how does the matter stand then? Strictly speaking, only so much of the income as is earned within the state should be assessed. But since it is exceedingly difficult to apportion the expenses of a large corporation among all its branches in different commonwealths, it would seem preferable to adopt some approximate standard by which the net receipts could be measured. The most practicable and easily ascertained test is gross receipts. Thus the most approved method of taxing corporate income would be to assess that proportion of the total net income which the gross receipts within the state bear to the entire gross receipts. Such a system would present no difficulties, and would preclude all chance of double taxation of this kind.

We have thus far considered only the question of complications arising from foreign or interstate taxation. Of minor consequence, but still of sufficient importance to deserve mention, are the problems of intermunicipal double taxation. They are of minor consequence because, in the United States at least, we have but very few instances of municipal or county taxes on the receipts, income or loans of corporations which do any business without the limits of the local divisions. On the other hand we do find local taxes on the total property and on the capital stock of corporations which have more than a purely local significance. Of course the rules should be the same as those applied above to cases of interstate taxation. But as long as so few of the commonwealths accept these principles, it will scarcely surprise us to find that the local divisions almost completely ignore them. Thus in New York city, the home of many huge corporations of national importance, it is the common practice to assess for local purposes the entire capital stock of the corporation, irrespective of the question whether a portion of its property may not be situated, or whether its stock may not be employed or owned, outside of the confines of the city. This is manifestly a crude and inequitable practice. Its injustice could be readily removed if the plan laid down in these essays were pursued; *i.e.* if corporations were taxed for local purposes on their real estate only. Ultimately, perhaps, if the local needs became more

pressing, a proportionate share of the proceeds of the commonwealth corporation taxes might be distributed among the local divisions. In this way no possible complications could arise from intermunicipal double taxation.

What can we learn from Europe on this whole subject of interstate or intermunicipal double taxation? The only countries in which such interstate complications can arise are the federal states of Germany, Austria-Hungary and Switzerland. In two of these an attempt has been made to regulate the matter.

In Switzerland the constitution of 1874 imposes on the federal legislature the obligation of preventing double taxation, without attempting, however, to analyze or point out the various forms of double taxation.[1] While several decisions of the Swiss courts have definitely settled some of the simpler problems of duplicate taxation, the particular questions that interest us under this fourth heading have not yet been adjudicated to any extent Beyond the principle that corporations, like natural persons, are taxable on their income and on their property by the canton where their chief office or establishment is situated,[2] or where their business is conducted, no successful attempt has as yet been made by the federal legislature or courts to solve the more complicated problems discussed above. A few of the separate cantons, however, have recently enacted into statute the principle that only so much of the capital or income as is employed or received within the commonwealth should be taxable. Such, for instance, is now the law in Vaud, Ticino and Baselstadt.[3] In Bern the same principle is applied to inter-

[1] Art. 46: "Die Bundesgesetzgebung wird . . . gegen Doppelbesteuerung die erforderlichen Bestimmungen treffen." A translation of the Swiss constitution has been published as number 18 of the Old South Leaflets, Boston, 1890.

[2] Zürcher, Kritische Darstellung der bundesrechtlichen Praxis betreffend das Verbot der Doppelbesteuerung (Basel, 1882), pp. 88–93; Schreiber [same title], p. 259. *Cf.* also, in general, Speiser, Das Verbot der Doppelbesteuerung (Basel, 1886).

[3] In Vaud, all individuals as well as private corporations or societies, "sont soumis à l'impôt pour tout le capital mobilier affecté au service de leur activité dans le canton." Loi d'impôt sur la fortune mobilière et sur la fortune immobilière, du 21 août, 1886, chap. iii, art. 12. Printed in Schanz, Die Steuern der Schweiz, V, 387; *cf.* also, IV, 128.—In Ticino, "le persone, le ditte commerciali, le società o gli enti morali in genere, che, non avendo il loro domicilio o la loro sede nel Cantone, vi tengonc

municipal taxation.[1] In Uri the taxable property and profits are calculated in proportion to relative mileage.[2] In Neuchâtel foreign corporations are taxable only for the profits earned within the commonwealth.[3] In Appenzell it is simply provided that corporations should pay the income tax in the place where the business is carried on, but in such a manner as to avoid double taxation.[4] The very recent law of Ticino is most interesting, for the further reason that it also imposes a tax on all corporate loans, but allows the corporation to deduct the tax only from the interest on the bonds owned within the canton.[5] Foreign-held bonds thus escape taxation in the hands of the individual holder except by the state of the owner's residence. It will be observed that the custom in Ticino is thus the exact reverse of the practice in the United States.

In Germany the conditions are much the same In 1870 an imperial law was enacted which forbade in express terms double taxation arising from interstate complications. This law provided that individuals should be taxed only by the state of their domicile, and that real estate should be taxable only by the state

stabilimento, succursale, agenzia, rappresentanza, o vi esercitano un' industria, oppure vi poseggono beni o rendite . . . sono tenuti al pagamento dell' imposta, in ragione della sostanza e della rendita che hanno nel Cantone." Legge sull' imposta cantonale (April 28, 1890), art. 14. In Schanz, V, 462. — In Baselstadt, "bei Gesellschaften welche neben der Niederlassung im Kanton auch eine solche ausserhalb des Kantons besitzen, tritt eine dem Umfange der auswärtigen Niederlassung entsprechende Minderung des Steuerbetrags ein." Gesetz betreffend die Besteuerung der anonymen Erwerbsgesellschaften, vom 14 Oktober, 1889, § 4. In Schanz, V, 50.

[1] "Bei Unternehmungen, die in verschiedenen Gemeinden ihr Gewerbe ausüben, ist die Steuer nach Verhältniss der Ausdehnung des Geschäfts an diese Gemeinden zu entrichten." Gesetz über das Steuerwesen in den Gemeinden, vom 2 Sept., 1867, § 7. In Schanz, V, 88.

[2] Uri, Steuergesetz vom 10 Mai, 1886, art. 13. In Schanz, V, 376.

[3] "Les sociétés anonymes . . . sont soumises au même impôt pour les ressources que leur procurent les affaires faites dans le pays." Loi sur l'impôt direct du 18 octobre, 1878, art. 6, § 3. In Schanz, V, 219.

[4] "Immerhin unter Vermeidung von Doppelbesteuerung." Vollziehungsverordnung über die Ausführung von Art. 16 der Verfassung betreffend das Steuerwesen (April 5, 1880), art. 6. In Schanz, V, 26.

[5] The corporations "sono tenuti al pagamento dell' imposta . . . sull' importo complessivo delle obbligazioni al portatore da loro emesse." But the law contains this further provision: "Non saranno colpiti dall' imposta i capitali [including the bonds] di cui . . . ove il contribuente dimostri che ciò costituirebbe una doppia imposta." . . . Arts. 15 and 3 § 3 of the law of 1890. In Schanz, V, 460, 462; *cf.* IV, 282.

of its location. The only clause affecting corporations prescribes that the occupation as well as the income from the business can be taxed only by the state where the business is carried on.[1] But the commission which drafted the law evaded the main question by asserting that the exact proportion of the corporate business or income taxed by any one state must depend on "the particular form of the actual conditions."[2] This, of course, has settled nothing, and the matter remains as before a subject for the separate states to regulate.

Several of the German commonwealths have now adjusted the difficulties in very much the same way that has been adopted or has been proposed in this country. Thus the Baden income tax law of 1884 provides that only so much of the corporate income should be assessed as is proportional to the amount of capital employed within the state.[3] So also the Prussian law of 1867 provides that the taxable net income of railroads which lie partly in other states should be estimated by the proportion of gross receipts within the state, and that this again should be calculated in proportion to the mileage within the state.[4] Finally the recent Prussian local tax law measures the proportion of corporate income or net profits due to each tax district by the share of the gross receipts in the case of banks and insurance companies, and by the share of the expenses for salaries and wages in the case of transportation companies.[5]

The tendency therefore seems to be the same in all countries. Whether the tax be imposed on property or on income, the law should be applicable to both domestic and foreign

[1] Reichsgesetz wegen Beseitigung der Doppelbesteuerung. Vom 13 Mai, 1870, § 3. Reprinted in Meitzen, Die Vorschriften über die Klassen- und klassifizierte Einkommensteuer in Preussen. No. 6.

[2] "Dass die Entscheidung immer von der besonderen Gestaltung der thatsächlichen Verhältnisse abhängen werde." *Cf.* Clauss, Das Reichsgesetz wegen Beseitigung der Doppelbesteuerung. In Schanz's *Finanzarchiv*, V (1888), 138–197, esp. 179.

[3] Badisches Einkommensteuergesetz v. 20 Juni, 1884, art. 5, lit. B. In *Finanzarchiv*, III, 368.

[4] Law of March 16, 1867, § 9. For the judicial decisions and rescripts on this point, see Clauss, *op. cit.* 181.

[5] Communalsteuernothgesetz von 27 Juli, 1885, § 7. Printed in *Finanzarchiv*, III, 174–193, together with an explanatory article by Secretary Herrfurth.

corporations; and while no deduction should be made for non-resident holders of stock or bonds, only so much of the property or income should be assessed as is employed or received within the state. And since an exact standard is unattainable, it is advisable to use the approximate test of relative mileage in the case of transportation companies and relative gross receipts in the case of other corporations.

XI. *Double Taxation of the Corporation and of the Holder of Stock or Bonds.*

We come finally to the fifth and most important division in the subject of duplicate taxation — the taxation of the corporation and of the shareholder or bondholder. The question is this: If we tax the corporation, shall we also tax the individual who owns the stock or bonds of the corporation? Is this double taxation? Is it unjust taxation?

Let us first discuss the actual practice both here and abroad. In the United States the legal conditions are chaotic. In some states the tax on the corporation is declared to be a tax on the shares, which are accordingly exempted from assessment. Thus in California the statute declares that "shares of stock possess no intrinsic value over and above the actual value of the property of the corporation for which they stand," and that to tax both corporation and shareholder is double taxation.[1] In Arizona we find exactly similar language used.[2] And in a large number of other commonwealths (Alabama, Florida, Idaho, Maryland, Michigan, Montana, Nebraska, New York, North Carolina, Ohio, South Carolina, Utah, West Virginia and Wisconsin) shares of stock in the hands of individuals are exempt when the corporation itself is taxed, although the reason of the rule is not always expressly stated as in the cases just cited.[3]

[1] Cal. Code, § 3608; *cf.* Burke *vs.* Badlam, 57 Cal. 594.

[2] Ariz. Code, § 2633.

[3] Ala. Revenue Code of 1884, sec. 2, § 8; Fla. Digest, chap. 138, sec. 10; Idaho Rev. Stat. §§ 1401, 1440; Gordon's Executors *vs.* Baltimore, 5 Gill, 231; Mich. Laws of 1885, no. 153, sec. 2; Mont. act of Mar. 14, 1889, § 9; Neb. Comp. Stat., chap. 77, art. 1, sec. 7; N. Y. Rev. Stat. Pt. I., chap. xiii, tit. i., § 7; N. C. Rev. Laws,

On the other hand the weight of judicial decisions in other commonwealths (Indiana, Illinois, Iowa, Louisiana, Maine, Massachusetts, New Jersey, Pennsylvania and Tennessee) is exactly to the contrary effect.[1] In some of these cases it has been held that "the tangible property of a corporation and the shares of stock are separate and distinct kinds of property under different ownership; the first being the property of the corporation and the last the property of the individual stockholder." Taxation of both corporation and shares of stock is hence pronounced neither duplicate nor unjust taxation, even though the shares of stock have no value save that which they derive from the corporate property and franchise.[2] In other cases again, it has been held that even though the taxes amount to double taxation, they are not unconstitutional. This, however, is true only in those states which like Pennsylvania admit double taxation even though it be confessedly unequal taxation.

Other commonwealths, again, take a less logical middle ground. In the case of certain corporations they do not permit taxation of both shares and corporation; in the case of other corporations they do not object to this simultaneous taxation. In the case of national banks, as we know, the taxation of the corporation itself is made impossible by federal law. Most of the states, therefore, tax only the individual shares, although they collect the tax through the corporation.[3] In many cases this system has been extended also to other banks besides na-

chap. 102, sec. 7; Ohio Rev. Stat., § 2746; S. C. Rev. Stat., chap. xii, sec. 6, § 19; Utah Comp. Laws, § 2009; W. Va. Code, chap. 29, sec. 51; Wis. Rev. Stat., sec. 1038, § 9.

[1] Conwell *vs.* Connersville, 15 Ind. 150; Porter *vs.* Railroad Co., 76 Ill. 561; Danville Banking Co. *vs.* Parks, 88 Ill. 170; Cook *vs.* Burlington, 59 Ia. 251; New Orleans *vs.* Canal Co., 32 La. 51; Cumberland Marine Railroad *vs.* Portland, 37 Me. 444; Tremont Bank *vs.* Boston, 1 Cushing, 142; State *vs.* Thomas, 26 N. J. 181; Whitesell *vs.* Northampton County, 49 Pa. State, 526; Pittsburgh Railroad Co. *vs.* Commonwealth, 66 Pa. State, 77; Emsly *vs.* Memphis, 6 Baxter, 553.

[2] So also in Switzerland this simultaneous taxation has been upheld on the strictly juristic ground that the corporation and the shareholder are distinct persons. See Speiser, Das Verbot der Doppelbesteuerung, and Roguin, La Règle de Droit (Lausanne, 1889), 141 and *passim*.

[3] See the first article of this series, POLITICAL SCIENCE QUARTERLY, V, 2 (June, 1890), pp. 279–283.

tional banks. A few commonwealths (Delaware, Georgia, Kansas and North Carolina) pursue this method with regard to all corporate shares in general, and collect the tax from the corporation.[1] But in Iowa, Kentucky, Vermont and a few other commonwealths the prohibition of simultaneous taxation of both shareholder and corporation applies only to definite classes of corporations.[2] In Massachusetts, curiously enough, the corporation is taxed and the individual shareholders are exempt as regards all dues except those for school-district and parish purposes.[3]

The decisions of the United States Supreme Court are somewhat conflicting. The earlier cases seem to uphold simultaneous taxation of corporation and shareholder. In a late case, however, the court asserts that double taxation is never to be presumed; and that, although the commonwealths have an undoubted right to levy such taxes, in the absence of a special statutory provision the presumption is against such an imposition.[4]

On this point, accordingly, we find an absolute contradiction of theory. In a cognate matter there is a still greater diversity of practice. Some commonwealths, as we have just seen, tax the stockholders on the full value of their shares, irrespective of the question whether the corporation has been taxed or not. In other states, however, only a portion of the value of the shares is taxable. Thus in Louisiana, Minnesota and Nebraska, in the assessment of shares of stock to the holders, a proportionate part of the value of the real and personal corporate property taxed within the state is deducted from each share.[5] In New

[1] Del. Laws, 13, chap. 393; Ga. Code, sec. 815; Kan. Comp. Laws, chap. 107, sec. 6; N. C. Machinery Act of Mar. 11, 1889, sec. 16.

[2] In Iowa the prohibition applies only to manufacturing companies, Acts 18th Gen. Assembly, chap. 57, §§ 1, 2; in Kentucky to turnpike, gas, telegraph, telephone, express, street-railway and toll-bridge companies, Revenue Law of 1886, chap. 1223, art. iv, § 8; in Vermont to railroads, Rev. Laws, sec. 270.

[3] Mass. Pub. Stat., chap. xi, sec. 4.

[4] Tennessee *vs.* Whitworth, 117 U. S. 136, 137; also, New Orleans *vs.* Houston, 119 U. S. 265. For the earlier cases, see Van Allen *vs.* Assessors, 3 Wall. 573; The Delaware Railroad Tax Case, 18 Wall. 230; Farrington *vs.* Tennessee, 95 U. S. 686; Sturges *vs.* Carter, 114 U. S. 511.

[5] La. Acts of 1888, no. 85, sec. 27; Minn. Gen. Stat., chap. xi; Neb. act of Mar. 1, 1879, sec. 32.

Hampshire and Tennessee a proportionate part of the real estate actually taxed is deducted from each share.[1] In Rhode Island a proportionate part of the real estate and machinery is deducted.[2] In Maine a proportionate part of the machinery, goods manufactured or unmanufactured, and real estate locally taxable is deducted.[3] Finally, in New York the statute (which applies however only to state and national banks) provides for the deduction of the assessed value of the real estate.[4] In all these cases only the property actually taxable within the state is deducted. But in Vermont, in the case of manufacturing companies the value of the corporate realty and personalty, and in the case of all other corporations the value of the realty, is deducted whether the property be located or taxable within or without the commonwealth.[5]

Such is the chaos in regard to shares of stock. The same question can of course arise in reference to the mortgage bonds. As regards the simultaneous taxation of corporate property and of the individual bondholder, the disagreement is less profound only because corporate loans are, as we know, rarely taxed. In the one commonwealth, Connecticut, where certain corporations pay what has been pronounced a property tax on the value of their stocks and bonds, it has been held not to be double taxation to assess the individual bondholder as well as the corporation.[6] And yet Pennsylvania and Maryland seem to come to the diametrically opposite conclusion, in so far as the bonds in these commonwealths are taxable only to the corporation and not to the individual bondholder.[7] In Pennsylvania we thus find the very illogical situation that, while the corporation is

[1] N. H. Gen. Stat., chaps. 53–55; Tenn. Laws, 1868–69, chap. 9, sec. 9.

[2] R. I. Pub. Stat., chap. 43, sec. 12.

[3] Me. Rev. Stat., tit. i, sec. 14, § 3.

[4] N. Y. Laws of 1866, chap. 761; Laws of 1882, chap. 409, § 312. *Cf.* People *vs.* Commissioners of Taxes, 69 N. Y. 91.

[5] Vt. Rev. Laws, tit. 9, chap. 22, sec. 288. *Cf.* on this point Moore, Corporate Taxation, in *American Law Review* for 1884, p. 771. Moore's statements are not entirely accurate.

[6] Bridgeport *vs.* Bishop, 33 Conn. 187.

[7] Pa. law of June 30, 1885, § 4; Md. Rev. Code, art. xi, sec. 97. Before the corporation tax law of 1880, the same principle applied to all corporations in New York.

taxable in both cases, the shareholder but not the bondholder is again taxable. Maryland escapes the difficulty by declaring neither stockholder nor bondholder liable. The federal Supreme Court virtually accepts this same principle in deciding that a tax on the bonds is a tax on the bondholder, not on the corporation.[1] It may be confidently asserted, therefore, that as soon as the taxation of corporate loans becomes as general as is now the taxation of corporate stock, we shall be confronted by precisely the same difficulties.

If now we turn to Europe, we shall find a still greater diversity of practice. Of the European countries, Switzerland is the only one in which some of the cantons still tax corporate property or capital stock. And in Switzerland the condition is just as chaotic as with us.[2] Thus one set of cantons (Grisons, Baselstadt, Aargau and Ticino) formerly taxed only the shareholder, not the corporation.[3] But the intercantonal complications soon assumed important proportions. It frequently occurred that the great majority of the shareholders resided in a different canton from the home of the corporation, to the manifest detriment of the public revenue in the original canton. Owing to this fact, the above system has now been abandoned by all the cantons except Glarus.[4] A second set of cantons tax the corporate property and income, but deduct the shares, dividends or interest in the hands of the security holders of domestic corporations from their taxable property or income. That is, they tax the corporation, but not the individual. This is the law in Schaffhausen, Bern, Vaud, Aargau and Uri,[5] and is the prac-

[1] State Tax on Foreign-held Bonds, 15 Wall. 300.

[2] *Cf.* in general, Schanz, Die Steuern der Schweiz, I, 90–99; and Zürcher, Kritische Darstellung betreffend das Verbot der Doppelbesteuerung, pp. 36–41.

[3] This was true in Grisons from 1871 to 1881; in Baselstadt up to 1879; in Aargau to 1885; in Ticino to 1890. See the respective laws in Schanz, *op. cit.* III, 247 (note 1); II, 40; V, 4, § 20; IV, 281.

[4] Gesetz über das Landessteuerwesen, vom 11 Mai, 1873, § 4; in Schanz, V, 175.

[5] Schaffhausen, Steuergesetz vom 29 Sept. 1879, arts. 9 and 10, in Schanz, V, 259; *cf. ibid.* II, 169; Bern, Vollziehungsordnung, vom 22 März, 1878, § 3, in Schanz, V, 83; Vaud, loi d'impôt sur la fortune mobilière du 21 août, 1862, art. 6, in Zürcher, *op. cit.* 38, *cf.* Schanz, IV, 158 (true only to 1886); Aargau, Grossrätliche Verordnung uber den Bezug der direkten Staats- und Gemeindesteuer, vom 26 November, 1885, § 7, in Schanz, V, 15; Uri, Steuergesetz, vom 10 Mai, 1886, art. 5, in Schanz, V, 375.

tice in Baselstadt, Schwyz and Zug.[1] The security holders of foreign corporations are, however, not exempted from taxation, as are those of domestic corporations. Grisons, moreover, has the curious provision that while corporations are taxed directly, only the shareholders of domestic corporations are exempt. The bondholders of both domestic and foreign corporations are taxable equally with the corporation.[2] In some of the above cantons the security holders are exempt only for commonwealth taxes, but are liable for local burdens. This is the case in Uri, Bern and Aargau.[3] It is the same system, it will be observed, as in Massachusetts.

A third set of cantons do not shrink from double taxation, but tax both corporation and shareholder. Such is the law in Baselstadt and Neuchâtel.[4] The decisions of the Federal Council are directly contradictory on this point.[5] Finally, a fourth set, — and this seems the growing tendency in Switzerland — seek to divide the tax between corporation and shareholder. Thus Geneva taxes the corporation on its realty and the shareholder on his shares; but does not permit the shareholder to make a proportionate reduction for the corporate realty already taxed, as is the case in New York, New Hampshire and Tennessee.[6] Appenzell taxes the shareholders on the market value of their shares, but the corporations only on their reserve fund.[7] In

[1] For these cantons, see the judicial decisions in Zürcher, *op. cit.* 38.

[2] Graubünden, Steuergesetz vom 28 August, 1881, § 16; in Schanz, V, 192.

[3] See the respective provisions in Schanz, V, 375, art. 5; 88, § 7; 15, § 7; and 19, § 18.

[4] Bern, Gesetz betreffend die direkten Steuern, vom 31 Mai, 1880, §§ 1, 8; and Gesetz betreffend die Besteuerung der anonymen Erwerbsgesellschaften, vom 14 Oct., 1889, § 1; in Schanz, V, 41, 43, 49; Neuchâtel, Loi sur l'impôt direct du 18 oct., 1878, art. 5 and art. 6, § 3; in Schanz, V, 218, 219. Schanz, I, 95, also includes Zug in this class, but erroneously, as appears from the official decision quoted in Zürcher, *op. cit.* 38.

[5] See the several cases in Schreiber, Verbot der Doppelbesteuerung, pp. 199–202. He opposes double taxation. But on the other hand, see Meili, Rechtsgutachten über die Besteuerung der Aktiengesellschaften, in the *Zeitschrift für schweizerische Gesetzgebung*, V, 489. See also Zürcher, *op. cit.* p. 40.

[6] Genève, Loi générale sur les contributions publiques, du 9 novembre, 1887, arts. 300, 324; in Schanz, V, 151, 155.

[7] Vollziehungsverordnung über die Ausführung von Art. 16 der Verfassung betreffend das Steuerwesen (April 5, 1880), arts. 5, 6. Schanz, V, 26.

Zürich the shareholders are taxed on their shares, the corporations on their reserve fund and on the income in excess of five per cent of the capital. The income below five per cent is not taxed because it is supposed to be hit by the tax on the shareholders. For purposes of local taxation, however, the shareholders are assessed on their shares, but the corporations only on their realty and a proportionate part of their reserve fund.[1] In St. Gallen the stockholder is taxed on his shares, the corporation only on its income in excess of four per cent interest on the capital.[2]

The recent "draft of a federal law on double taxation" sought to divide the tax between corporation and shareholder in a new way. The stockholder was to be assessed by the place of his domicile on the market value of his shares up to the amount actually paid or on the dividends up to five per cent. The corporation was to pay only on the surplus value of the capital or dividends above this figure.[3] Such a plan, however, is not very logical. Although this particular draft failed of adoption because of the jealousy of the individual cantons at the supposed infringement of their state rights, the principle has nevertheless been accepted by a single commonwealth — Vaud. In this canton all shares which stand above par and all bonds which pay more than four per cent interest are assessable to the individual owners at their par value. The corporations are assessed only on the surplus above the capital stock, *i.e.* the reserve and sinking funds and other sums earned during the year.[4] Such a clumsy method is not likely to be adopted in this country. We see that Switzerland has no settled practice at all.

[1] Gesetz betreffend die Vermögens- Einkommen- und Aktivbürgersteuer vom 24 April, 1870, §§ 2, 4; Anleitung betr. das bei der Selbsttaxation . . . zu beobachtende Verfahren, § 6; Gesetz betreffend das Gemeindewesen, § 137, d, e. Schanz, V, 423, 424, 431, 439; II, 435. *Cf.* Zürcher, *op. cit.* p. 39.

[2] Gesetz über die Einkommensteuer, sowie über die Besteuerung der anonymen Gesellschaften (1863), art. 5; Verordnung über Besteuerung der anonymen Gesellschaften vom 28 Jan., 1867, arts. 4, 11. Schanz, V, 309, 311.

[3] Bundesgesetzentwurf vom 6 März, 1885. In Schanz, I, 96.

[4] "Les actions et parts de sociétés qui ont leur siége en Suisse et dont le cours à la Bourse est supérieur à leur valeur nominale ou qui rapportent un intérêt supérieur au 4 per cent de cette valeur, sont comptées dans la fortune mobilière du porteur ou

In the other chief European countries neither general property nor capital stock is taxed at all. The whole system is one of income taxation. But the same questions arise as to the taxation of corporate profits and of shareholders' or bondholders' income.

In England the income tax payable on annual profits or gains according to schedule D of the income tax is paid directly by the corporation, and is deducted by it from the dividends or coupons due the security holders. These are then to that extent exempt from the income tax.[1] In Austria the facts are similar to those in England.[2]

In Italy the law requires the income tax to be paid by the corporation, but does not interfere with the adjustment of the tax between the company and the shareholders. Nothing would prevent the corporation from deducting the tax from the dividends. In fact, however, it is the custom for the corporation to charge the tax to expense account. The result for the shareholder is the same. He is not assessable on his dividends because the law expressly forbids double taxation of this kind.[3] As regards bondholders the companies are required to pay the tax on coupons, with a right to recoup from the bondholders.[4] The companies generally do not deduct anything from the coupons, but, as with the tax on dividends, simply charge it to expense account. In that case it would seem as if the stockholders were liable for the tax, since, strictly speaking,

des créanciers pour leur valeur nominale seulement. . . . L'avoir net (réserves et amortissements compris) des sociétés . . . est compté dans la fortune mobilière de ces sociétés pour tout ce qui excède le capital social." Loi d'impôt sur la fortune mobilière, *etc.*, du 21 août, 1886, art. 11. Schanz, V, 387; *cf.* IV, 158.

[1] Ellis, A Guide to the Income Tax Acts, pp. 78–112.

[2] Wagner, Direkte Steuern, § 103, in Schönberg, Handbuch der politischen Oekonomie, III, 307. Wagner's discussion of double taxation is most fragmentary and inconclusive.

[3] "Ne saranno soltanti eccettuati [in the taxable income] i redditi che per disposizione della presente legge siano già una volta assoggettati all' imposta in essa stabilita." Legge per l' imposta sui redditi di ricchezza mobile, art. 8, § 2.

[4] ". . . Le società anonime dichiareranno non solo i redditi propri, ma eziando . . . gli interessi dei debiti da loro contratti e delle obbligazioni da loro emesse, e pagheranno direttamente l' imposta relativa anche a questi ultimi redditi, rivalendosene sui loro assegnatori e creditori mediante ritenuta." *Ibid.* art. 15.

the tax paid by the corporation would have to come ultimately out of the stockholders' dividends — not out of the bondholders' interest, which is legally fixed. In actual practice, however, this distinction is not observed. The bondholders, moreover, are not assessable if the corporation has paid the tax.[1]

In France the *taxe sur le revenu des valeurs mobilières*, in so far as it applies to the dividends or coupons of corporate securities, may be primarily collected from the company and then deducted by it from the sums due the security holders, as in England; or the tax may be assumed directly by the companies,[2] as in Italy, in which case, as we have seen, the shareholder and not the bondholder suffers. This actually makes a distinction the significance of which will be pointed out in a moment.

In Germany every possible plan has been tried, without any definite or uniform conclusions being reached. The matter is further complicated by the fact that corporations like individuals must pay a business tax (*Gewerbesteuer*), somewhat akin to our Southern licenses or occupation taxes. In a large number of German states (*e.g.* Prussia, Oldenburg, Brunswick, Gotha, Schaumburg-Lippe, Waldeck and Lübeck) the corporations pay no income tax, but the shareholders and bondholders are taxed on their income.[3] In other states, like Saxe-Weimar, Lippe-Detmold, Bremen and Hessia, the corporations are assessed, but the shareholders and bondholders are exempt.[4] Even in these

[1] For much official information and for valuable documents on the taxation of corporations in Italy, my thanks are due to Signor Luigi Bodio of Rome and Professor Rabbeno of Bologna.

[2] Tanquérey, Traité . . . de l'impôt sur le revenu des valeurs mobilières, pp. 143–150; Vignes, Traité des impôts en France I, 405–409; Kauffmann, Die Finanzen Frankreichs, pp. 288, 291.

[3] *Cf.* the details in Antoni, Die Steuersubjecte im Zusammenhalte mit der Durchführung der Allgemeinheit der Besteuerung nach den in Deutschland geltenden Staatssteuergeltzen. *Finanzarchiv*, V, 916–1033, esp. 1010.

[4] Sachsen-Weimar, Gesetz über die allgemeine Einkommensteuer, v. 19 März, 1869 [with amendments of 1874, 1877 and 1880], §§ 48 and 4. Printed in *Finanzarchiv*, II, 932. — Lippe-Detmold, Gesetz die Klassen- und klassifizierte Einkommensteuer betreffend, v. 1868 [with amendments of 1882 and 1885], §§ 1, 7. — Bremen, Einkommensteuergesetz, v. 17 Dez., 1874, § 5. — Hessen, Gesetz, v. 1884, die Einführung der Einkommensteuer betreffend, arts. 4, 19. In *Finanzarchiv*, II, 383–434. For Hessia in particular, see Schanz, Die direkten Steuern Hessens und deren neueste Reform. *Finanzarchiv*, II, 235–529. Also Conrad's *Jahrbücher*, XII, 40.

commonwealths, however, the definitions of corporate net income do not tally exactly. In most of the remaining states, like Saxony, Baden, Bavaria, Würtemburg, Mecklenburg, Anhalt and the other minor commonwealths, both corporation and security holder are taxed, — the corporation on its income or business, the individual on his income from the corporate security.[1] In one case (Baden) the same income is even taxed four times. That is, the corporation pays a business tax (*Gewerbesteuer*) and an income tax, while the individual shareholder or bondholder pays not only an income tax but also a tax on the interest of his capital invested in the bonds or stock (*Kapitalrentensteuer*).[2] In the recent draft of the bill to reform the Prussian law, this same quadruple taxation was proposed.[3] But its absurdity was so manifest that the whole project failed. It was also proposed in Hessia, but without success. So that Baden is the only state in the world which can pride itself upon assessing the same object four times.

We see hence that in Europe there is no settled practice at all. The tendency on the whole seems to be to tax the corporation and to exempt the individual for his income from corporate investments. Is this the correct policy? Is it true that in taxing the corporation, whether on property or on income, we are taxing the individual holder of the shares or bonds?

This brings us to the pith of the question. What is the incidence of the corporation tax? Where does the burden

[1] Sachsen, Einkommensteuergesetz v. 1878, § 4.—Bayern, Einkommensteuergesetz v. 1881, art. 1, 15. In Seisser, Die Gesetze über die direkten Steuern im Kgr. Bayern, I, 158. — Würtemberg, Gesetz v. 1872, art. 1, § 3. In Sammlung württembergischer Steuergesetze (1883). — Mecklenburg, revidiertes Contributionsedict v. 1874, §§ 13, 45. — Baden, Gesetze v. 1884, die Einführung einer allgemeinen Einkommensteuer betreffend, art. 5. In *Finanzarchiv*, 361–394. *Cf.* Philippsberg, Gesetz über die direkten Steuern in Baden (1888). — Anhalt, Gesetze v. 1886, Einführung einer Einkommensteuer . . . betreffend, §§ 2, 4. *Cf.* Schanz, Die Steuern im Herzogthum Anhalt, ihre Entwickelung und neueste Reform. *Finanzarchiv*, IV, 961–1070, esp. 1016.

[2] *Finanzarchiv*, II, 320. *Cf.* Lewald, die direkten Steuern in Baden; *Finanzarchiv*, III, 350.

[3] Einkommensteuergesetzentwurf von 1883.

really fall? This question has never yet received adequate attention.[1]

XII. *Incidence of the Tax.*

It is generally assumed that the tax on the corporation is a tax on the shareholder or bondholder. But a distinction must be drawn between the original holder and the recent purchaser of corporate securities. From the best consideration that I have been able to give to the question, it seems that in certain cases the tax is not borne by the purchaser of new corporate securities, but that it falls entirely on the original holder of the old securities issued before the tax was imposed. Let us take the case where the corporation is taxed on its income. A corporation previously untaxed has been paying, let us suppose, five per cent dividends on its stock quoted at par. If a corporation tax of ten per cent be imposed on the dividends, the stockholder will get only four and a half per cent. As we must assume, however, that the usual rate of profits on other non-corporate investments has remained unchanged, the price of the stock *ceteris paribus* will inevitably fall to ninety. People who can get five per cent on their capital will not ordinarily consent to take four and a half per cent. While therefore the original holder of the stock will lose doubly — once in his decreased dividends, and again in the depreciation of his capital invested in the shares — the new purchaser who buys at ninety will lose nothing. He will on the contrary virtually escape taxation entirely. The amount of the tax is previously discounted in the depreciation of the security. With the lapse of time and the fluctuations in the market the original holders all disappear. Hence at any given time an income tax levied only on the corporation and not on the shareholder does not affect any one except the few original holders who bought before the imposition of the tax. It is only a question of a few decades until this class of original holders disappears entirely.

[1] The nearest approach to a discussion of this question is to be found in Helferich, Ueber die Einführung einer Kapitalsteuer in Baden; Tübinger *Zeitschrift fur die gesammte Staatswissenschaft*, 1846, pp. 291–324, esp. 315 *et seq.*

As to bondholders, the argument is precisely the same as in the case of stockholders, if the corporation is empowered to deduct the tax from the coupons. The lower rate of interest is discounted in the depreciation of the bond, so that the new purchaser loses nothing. But in those cases where, as frequently happens, the tax is borne by the corporation and not deducted from the coupons,[1] the bondholder does not suffer at all, except in the very indirect sense that it somewhat lessens the ultimate security of the mortgage.

Of course this is more or less true of all new taxes under certain conditions. A new tax affects the original owner of the taxable article more than the new purchaser. In the case of direct taxes the original holder is injured while the future purchaser discounts the tax in the depreciation of the article. In the case of indirect taxes the reverse is true. For the effect of the tax is to increase the price of the article. The lucky owner who holds the article before the imposition of the tax reaps the benefit of the rise in price. But the intricate point which is usually overlooked is the question whether the new tax is a general or a partial tax. If the direct tax applies to all subjects in the class and to all classes, then the new purchaser is taxed equally with the original owner. For if the tax is general there will be no depreciation in value. It is only when the tax is a partial tax, assessing some articles in the class more than others, that the tax will virtually be capitalized, and that a decrease of the value of the overtaxed article will ensue.

If we apply this principle to the corporation tax we reach the following results. If the corporation tax simply forms a part of a general scheme of income taxation, as in England or Italy, then no serious injustice is done by exempting the shareholder.

[1] During the Civil War, when a federal tax was imposed on the coupons and dividends of certain corporations, many corporations declared these "free of tax," and refused to withhold the amount from the sums due to the bondholders and stockholders. They simply assumed the tax and charged it to expense account, asserting that while the law authorized, it did not direct them to withhold the tax. See *Internal Revenue Record*, vol. i (1865), p. 153. — The practice was thus the same as in Italy to-day.

The tax affects the interest on all investments, not simply on corporate securities. The investor, whose interest was cut down in our supposed case to four and a half per cent, will not find any non-taxable securities of equal desirability from which he can obtain five per cent. Thus the whole reasoning of the case falls away. In such a case, therefore, the tax on the corporation is a tax on the investor. To tax both corporation and individuals on their income would hence really be double taxation. But on the other hand, if the corporation tax is a partial tax, — *i.e.* if only corporate securities and not the other securities are taxed, as in France, or if only a few classes of corporations are taxed, — then the taxation of the corporation is not sufficient to reach the purchasers. The purchaser will practically escape the tax because the freedom of investing in non-taxable securities will enable him, as explained above, to discount the tax in the price he pays. To tax both corporation and shareholder in such a case is hence not unjust taxation or double taxation. To tax the corporation alone would in reality exempt the shareholder who has purchased after the tax was imposed. And with the lapse of time this class will include all shareholders.

Thus far we have been discussing the incidence of the corporation tax in a scheme of income taxation. How does the matter stand in the case of the property tax?

The principle is identically the same. Let us assume that in addition to the corporation tax a general property tax is actually levied on all individuals. In such a case the corporation would pay the tax assessed upon it, and the individual would pay upon the corporate shares and bonds. This would indeed be duplicate taxation, but only on the assumption that the corporation tax is imposed on all corporations in general, and that the property tax is actually assessed on all kinds of property. In such a case it would be unjust to tax both corporation and shareholder. This is the assumption made by most of the American commonwealths, which, as we know, generally exempt the shares when the corporate property or franchise is taxed.

But the assumption is incorrect. In the first place, only

special classes of corporations are usually taxed. Secondly, the general property tax we know to be so only in name. By far the larger part of personal property or investments in the hands of individuals escapes taxation. Under these conditions the matter is entirely different. The corporation tax will now be discounted in the lower market value of the shares, because, other things being equal, the value of new investments will vary in proportion to the net profits to be derived therefrom. Although the corporate tax reduces the dividends, yet the reduced dividends on the reduced value will, as an investment, still equal the larger dividends on a property of greater value — greater because untaxed. Although the sums are smaller, the percentage is the same. Thus where there is only a partial tax on personal property the corporation tax puts the new purchaser of shares in the same position as if he owned non-taxable property, *i.e.* it practically exempts all the shareholders except the original owners. In the case of bondholders where the corporation tax is deducted from the coupons, this is equally true. And when the corporation tax is assumed by the corporation and not deducted from the coupons, — the almost universal rule in this country, — then the bondholders are certainly not reached at all, except in the very indirect way that they may be exposed to an ultimate diminution in the security of their lien. But the tax as such does not strike them at all. Their property, consisting of corporate bonds, goes scot free. A property tax or franchise tax on the corporation, under the given conditions, is not a tax on the individual holder of corporate securities.

The practical conclusion applicable to the United States to-day is as follows. It is frequently proposed that the general property tax be abandoned, and that it be replaced by a tax on real estate. This is not the place to enter into a discussion of the incidence of such a tax. But it may be declared a gross mistake to believe that such a tax will shift itself equally over the whole community, so as to produce practical equality of taxation. This Physiocratic, complacent, easy-going doctrine has been abandoned, for reasons not to be discussed here, by all scientists and even by many practical reformers in this country.

Their plan now is to supplement the real property tax by a tax on corporations, on the assumption that it will be possible to reach in this way on the one hand the owner of realty, and on the other the owner of personalty.

But if the preceding analysis is correct, the imposition of a corporation tax together with the real-estate tax on individuals is still inadequate to realize the principles of uniformity and equality. If the personalty of individuals is exempt, then a corporation tax, however assessed, is insufficient to reach the owners of personalty. For it would at best, even in theory, reach only the owners of a limited class of personalty, *i.e.* of corporate securities. And in actual practice, as has been shown, it would not reach even these, because the tax would be discounted in the depreciation of the corporate stock or bonds. The new purchasers — that is, after a short time all the possessors — would still go virtually untaxed, together with all those individuals whose personalty consists in non-corporate investments. To continue the general property tax in its present shape is rank injustice. To abolish the personal property tax and to replace it by the corporation tax is indeed an easy method of securing revenue for the state. It constitutes an undeniable step in advance. But it is still inadequate to attain justice as among the taxpayers. The corporation tax, in other words, if it be assessed on the correct principles laid down in these essays, is a step forward in reform and deserves on that account our hearty good wishes. But it is not the ultimate solution of the problem of equitable taxation.

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